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Promoting Agribusiness in Sri Lanka

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Summary

USAID began its support of agribusiness development in Sri Lanka in the late 1980s. Its agribusiness program now consists of three major projects and two small cofinancing projects that directly or indirectly promote the growth and expansion of the agribusiness sector. Two of the major projects focus only on the Mahaweli region, a massive irrigation resettlement scheme involving more than 60,000 families.

The agribusiness program has followed a variety of intervention strategies, particularly in Mahaweli. It has provided technical assistance to agribusiness firms and farmers producing high-value cash crops, it has helped strengthen public and private sector institutions that regulate agriculture or provide support services, and it has tried to foster links between local entrepreneurs and international firms. Its multifaceted approach to agribusiness growth has been both timely and relevant.

But the overall performance of the program so far has been uneven. The program has made definite, albeit modest, headway in promoting micro- and medium-size agribusiness enterprises, it has helped farmer organizations undertake a variety of agribusiness functions, and, to a lesser extent, it has promoted nontraditional agricultural exports by large national firms. But its record in promoting commercial farming in Mahaweli has been discouraging, and its efforts at generating significant agroprocessing have mostly failed. Nor has it succeeded in attracting direct investment by international firms.

The program succeeded in generating employment and income in rural areas. It helped increase employment mostly on farms producing high-value cash crops, which in general are labor intensive. Farm wages also rose, albeit marginally, in areas producing gherkin, an export crop, and incomes increased for farmers cultivating high-value crops, which fetch higher prices than paddy. Women also benefited. Although they now work more, they are more economically independent. Their increased wealth has in turn improved their families' living standards.

The program's most important achievement has been in helping to change the attitude of elites toward the growth of private sector

agribusiness. Through policy dialogue, workshops, and training sessions program staff have worked to change the attitude of decision-makers and national planners, but their efforts would not have succeeded without the simultaneous progress in Sri Lanka's overall policy environment.

Country Setting

After a period of poor economic performance in the early 1970s, the Government of Sri Lanka introduced economic policies in 1977 that were gradually to increase the role of markets by relaxing regulations on the private sector. Reforms reduced restrictions on pricing, payments, and investment and external trade. The supply response was strong the average annual growth rate for gross domestic product (GDP) only 3 percent in the early 1970s increased to 6 percent from 1978 to 1982. But by the mid 1980s the pace of economic reform began to lag and economic growth suffered.

With the help of bilateral and multilateral donor agencies, the Sri Lankan Government launched policy reform again, starting in 1989. It introduced a market-determined exchange rate, removed most price controls and subsidies, and privatized many government-owned enterprises. The results have been encouraging. GDP has grown 5 percent a year, budget deficits have been reduced by one-third, inflation has been cut nearly in half, and domestic and foreign private investment have rapidly expanded.

In the midst of such reform, Sri Lankan agriculture still remains modestly protected and regulated, with many cropping and land-use restrictions and overprotection of rice as compared to other crops. Government policy has emphasized rice self-sufficiency instead of increased agricultural production and efficiency. And inefficient government-owned enterprises dominate the plantation subsector. With the exception of plantations, most farms are smaller than one hectare. Most farmers grow mainly rice for home consumption, plus a small marketable surplus of rice, fruits, and vegetables to be sold in nearby market towns. Productivity, especially for rice, is low on these small farms so there is little marketable surplus and little value added in storing, processing, and marketing agricultural commodities. Except in the plantation subsector, private agribusiness enterprises have not contributed significantly to the national economy until recently.

The USAID Program

Since the late 1980s, USAID has funded several projects that have directly or indirectly promoted private sector agribusiness development in Sri Lanka. Two of the main projects focus exclusively on Mahaweli. The \$23-million Mahaweli Agricultural and Rural Development Project (MARD) is the first major agricultural development project to also promote agribusiness growth. Its purpose is to fully develop 21,314 hectares of irrigated land and 28,609 hectares of unirrigated uplands, supporting 25,151 settler families. It aims to move production from paddy to more profitable diversified crops for both domestic and foreign markets. Approved in FY 1987, this 8-year project is scheduled for completion in FY

1995.

MARD seeks to give Mahaweli farmers better access to markets by improving quality control, transportation, storage, packaging, post-harvest handling, and links to exporters and brokers. Special marketing funds can be used to introduce export crops in sufficient volume to test international markets before starting large-scale production. MARD includes a Farmer Investment Program, which encourages investment by resource-poor settlers, and a linked Farmer Investment Fund, which these settlers can use to begin converting to commercial farming.

The second project, the \$15 million Mahaweli Enterprise Development Project (MED), is designed to create more private enterprise jobs at all levels from microenterprise to large-scale ventures by increasing private investment and promoting high-value crop production, processing, and export. The project, which began operation in 1990, supports a broad range of business promotion efforts, including activities to support agribusiness expansion. The \$1.5 million policy component of the MED project supports policy studies on factors affecting the investment climate. The \$5 million medium- and large-scale enterprise component provides venture development assistance to encourage investment in the Mahaweli region. It provides technical assistance to help develop new technologies and new markets and, for selected pioneering ventures, offers matching grants to help pay preinvestment costs and reduce risks. The \$8.5 million small-scale enterprise component provides advice and training to small businesses (mostly microenterprises not directly related to agribusiness), helps them establish links to domestic and export markets, and helps them get credit.

The third major intervention, the Agricultural Enterprise (AgEnt) Project, was designed to stimulate the development and expansion of private agroenterprises for domestic and export markets. It began in December 1992 with a \$14 million grant. A private sector operation, the project helps emerging and expanding agroenterprises through technical services (in production, processing, and marketing), research and training, and investment packaging. AgEnt is a national project too recent to produce tangible results at the time of the CDIE evaluation.

Program Performance and Outcomes

The USAID agribusiness program has helped create and expand with varying degrees of success five types of business enterprise: large, medium-size, and micro- agribusiness firms; commercial farms; and farmer organizations.

Large agribusiness enterprises. Each of the three major projects (MARD, MED, and AgEnt) has encouraged large national and international firms to invest in agricultural processing and marketing. Two modern packing houses and cold chains have been established in Mahaweli. The first, TESS, which became operational in 1992 and received \$340,000 from the MARD project, has failed to attract major clients and was incurring substantial losses. The

second, ACE Processing LTD, received \$300,000 from MED. It catered primarily to its parent company but was expected to serve other clients in the future.

Outside of the plantation sector, 15 to 20 large agribusiness enterprises employ 25 or more full-time or equivalent part-time employees. More than half of them have started some production and marketing in Mahaweli. More important, many large firms have become involved with nontraditional agricultural exports. One crop these firms are successfully marketing is gherkins, a highly labor-intensive crop that grows easily in Mahaweli. Five major firms (Forbes, Sunfrost, Pickle Packers, Vanatha Vineyard, and Atkin Spence) have encouraged the cultivation of gherkins on 470 acres in Mahaweli. Agribusiness firms have also started exporting such high-value crops as baby corn, cashews, okra, eggplant, and broccoli. The volume of these exports remains almost insignificant but demonstrates untapped potential for nontraditional exports. Medium-size agribusiness enterprises. Although the USAID program assists medium-size firms (enterprises employing 5 to 24 full-time employees or equivalent), these firms have not received as much attention as have large enterprises. Roughly 25 to 35 medium-size firms produce high-value agricultural products or engage in milling and grinding, marketing, or the supply and repair of agricultural implements. About a third of these firms export fruits, vegetables, and ornamental fish.

A majority of these firms received technical assistance from the USAID program. In a survey commissioned by CDIE, participating firms reported being highly satisfied with the quality of the assistance they received. But two-thirds of the enterprises had received no other type of assistance. Many believed that training, market information, technology, and easier access to credit and input supplies would have been as important to their growth and expansion as was technical assistance, if not more so.

Agribusiness microenterprises. Agribusiness microenterprises (firms that employ one to four full-time employees or equivalent) represent nearly half of the microenterprises in Mahaweli. The MED project assists microenterprises through its 12 Mahaweli Business Centers, which offer both advisory and support services. These centers help existing and potential entrepreneurs formulate business plans, learn bookkeeping, procure credit, form savings and credit societies, and gain access to secretarial and communication services.

A CDIE survey found that 93 percent of agribusiness microenterprises are individually owned, but only 10 percent are owned by women a figure below the average of 18 percent for all microenterprises assisted by MED. Employment by the agribusiness microenterprises surveyed increased. An overwhelming majority of microenterprises added at least one full-time employee during 1991 to 1993. USAID assistance focuses on general training, technical advice, and access to credit. It does not cover the marketing and procurement of inputs, areas of critical importance to new entrepreneurs. Recently, MED has been trying to remedy the situation.

On the whole, the USAID program has encouraged the growth of microenterprises. Those who receive assistance value it; they certainly want more, not less, of it. But the USAID program has reached only a fraction of potential entrepreneurs. The business centers have ambitious plans for Mahaweli, which are unlikely to materialize because of time and resource constraints.

Commercial farms. The USAID program promoted commercial farms of 10 to 20 hectares in Mahaweli with the expectation that they would pioneer in the adoption of exportable high-value crops and more sophisticated technologies and would help improve marketing arrangements. About 2,500 hectares of irrigable uplands were earmarked for commercial farms and provision was made for more such farms later in other areas. Entrepreneurs were to be given transferable leases for up to 30 years, depending on the nature of the proposed project and the crops to be grown.

Progress at the time of the assessment was disappointing. The original target of establishing about 50 to 70 farms initially was unlikely to be met. The number of these farms was declining rather than increasing from 36 farms in mid-1992 to only 26 at year's end. Many farms stopped cultivation after 1 or 2 years of operation, others cleared only a small part of the allotted lands, and still others cultivated only one or two crops. A MED evaluation in 1993 categorized only two farms as good and another six as fair. At the end of 1993, MED discontinued assistance for commercial farming.

Farmer organizations. Finally, the USAID program (especially MARD) has been innovative in assigning agribusiness roles to farmer organizations, which are organized mainly to promote the efficient grassroots management of water resources. There are now about 120 such organizations, of which 60 percent are in fair to good condition. By October 1993, 22 farmer organizations were registered and registration was pending for another 25.

Farmer organizations have undertaken four types of agribusiness-related activities. First, many have signed contracts on behalf of their members, under which private firms or public bodies provide agricultural inputs for specific crops and agree to purchase the produce (see Box 1). Member farmers grow the crops on their own farms but sell them collectively.

Second, farmer organizations have also begun purchasing agricultural inputs fertilizers, insecticides, and pesticides wholesale to sell to their members, at a small profit. Third, under a subsidy scheme, farmer organizations have started acquiring two-wheel tractors, which they rent to their members for plowing, pumping, threshing, and transporting. By September 1993, 18 farmer organizations had tractors, and another 28 were expected to get them by year's end. Finally, many farmer organizations help to market their members' agricultural produce. Occasionally, they even buy and sell it when prices are high, an arrangement advantageous to farmers who often have to sell produce at the end of the harvesting season, when prices are depressed. In 1993, one

organization received loans from two banks to purchase paddy from its members, which it sold later at higher prices, making a net profit of Rs. 106,970 (\$2,140). The farmer organization will use its profits as a down payment on a delivery van for agricultural produce.

It is too soon to generalize about the agribusiness activities of farmer organizations, but USAID efforts in this area look promising indeed.

Economic and Social Impact

Effects on employment and income. Direct employment in agribusiness enterprises remains limited. In Mahaweli, the number of workers in agribusiness enterprises is in the hundreds, not the thousands. Only 8 to 10 large agribusiness firms have invested in Mahaweli, and only 25 to 35 medium-size enterprises have done so. Moreover, most firms do not engage in significant production and processing of agricultural crops, so they employ few workers an average of only 17 full-time and 9 part-time workers. Agribusiness microenterprises are more prevalent than large and medium-size firms, but employ fewer workers (an average of fewer than four). Employment has been affected most on farms producing high-value cash crops. Most of the crops promoted by MARD are highly labor intensive. Gherkins, for example, require five times the labor of paddy, and chili more than three times the labor. Farm households provide most of the labor but farmers producing high-value crops often need outside labor, so demand for workers has increased in Mahaweli. The cultivation of gherkins has even caused labor shortages in some areas.

Farmers and agribusiness firms both have paid minimal wages because of Sri Lanka's high unemployment and underemployment. Female workers are usually paid less than their male counterparts. As a result of crop diversification, wages of agricultural workers appear to have risen, albeit marginally, in export crop producing areas, especially where gherkin production has caused labor shortages.

Incomes have risen for farmers cultivating high-value crops, which fetch higher prices than paddy. According to a MARD study, gherkins produce nearly four times the net returns paddy produces, followed by red onions (two and a half times) and eggplants (one and a half times). Disbursements to farmers under contract with agribusiness firms, increased during 1990-1992: Agribusiness firms paid farmers almost Rs. 93 million (\$1.9 million) for cash crops over 3 years. Economic Rates of Return (ERR). The MARD project was designed to raise rural income by encouraging farmers to shift from paddy (rice) production into high-value crops such as gherkins, onion, melons, and chili. However, two factors have severely limited benefits. First, crop diversification has been very modest. In 1993, out of a total of 10,000 to 12,000 hectares, nonpaddy crops covered only 160 hectares in the maha season and 597 hectares in the yala season. Second, the net return of nonpaddy crops compared with paddy crops has not been high. The incremental benefits for the few farmers who did diversify was less than \$70 per crop

season. Moreover, the new crops are very labor-intensive, which means a large increase in farm family work hours. The ERR for the MARD project is barely positive.

The MED project was designed to increase employment, and, in fact, employment in the Mahaweli region has grown rapidly over the last few years. One problem, though, is that the new jobs are not highly productive; the economy gains only \$150 a year for each new job. A different issue is causality: how much of the employment gain is due to the MED project and how much is a result of other economic factors? If all the employment gains are attributed to the MED project, the ERR is 21 percent. If, conversely, only half the employment gains are due to MED, the ERR drops to only 1 percent. The low-end estimate of 1 percent seems more reasonable than the high-end estimate.

Impact on women. Women own only 10 percent of agribusiness microenterprises in Mahaweli, do not have major or controlling shares in large and medium-size firms, and own no commercial farms. Although the USAID program did not directly promote women's ownership of agribusiness and commercial farms, the program staff and decision-makers have taken steps to make training and technical assistance reach women entrepreneurs. Business consultancies to women, for example, have increased steadily in the MED project, from only 675 consultancies to women in 1991 to 1,585 in 1992. The agribusiness program has affected women in three ways. For one thing, they work more. As the agribusiness sector has grown, women workers' and farmers' workloads have increased considerably. Women are employed by agribusiness firms, by commercial farms, and, particularly, by outgrower farmers; but more important, they work as unpaid laborers growing high-value crops on family farms. As expected, women's employment in agribusiness or their unpaid work on household farms does not mean their traditional household responsibilities decline significantly.

At the same time, women workers are more economically independent. Because of Sri Lanka's high literacy rates, women are aware of their rights and do not normally hand their earnings over to their husbands, although it is not uncommon for grownup daughters living with their parents to share their incomes with parents. Most experts agree women relish their financial independence enough to seek outside work.

The increased income has improved standards of living, which benefits both men and women. Even when earnings accrue to men, there is no evidence that they spend disproportionately on themselves. Family ties are strong in this South Asian country and family interests predominate even in the midst of poverty. Receptiveness to private-sector-led growth. The single most important effect of the agribusiness program has been to slowly but perceptively change the elites' attitude toward the private-sector-led growth of agribusiness (see Box 2). This has important implications for Sri Lanka's economic growth.

Several program activities have encouraged this important change. First, the program staff, in cooperation with other international

donor agencies, holds policy dialogues with national planners and decision-makers stressing the growth of the private sector and of agribusiness. Second, the program organizes workshops, meetings, and training sessions on agribusiness for government officials, business executives, and the staffs of agribusiness firms. Third, over the past 3 years the program has produced hundreds of publications on technical and management issues relating to agribusiness. Fourth, the program's technical assistance to large, well-connected agribusiness firms is often widely and favorably reported in the press. Finally, the USAID program has built a small constituency in academic circles by providing grants for research and training and opportunities for consultancies.

But these activities would not have changed the attitude of elites had the program not been visibly successful in promoting nontraditional agricultural exports. Newspapers and magazines often report success stories comforting to national decision-makers and policymakers desperate about foreign exchange problems. As a result, decision-makers and policymakers have begun to appreciate the promotion of agribusiness through the private sector.

Factors Affecting Program Performance and Impacts

The program particularly the MARD and MED projects was launched in a trying and politically uncertain environment. Leftist insurgencies and ethnic conflicts created law-and-order problems in Mahaweli and elsewhere in Sri Lanka. The situation has improved, but the negative impact of an ongoing civil war cannot be underestimated.

What has boosted performance more than anything else, probably, is the policy of economic liberalization and structural adjustment Sri Lanka has followed in the past few years. The improved economic climate has encouraged more investment by both domestic and foreign firms, and entrepreneurs are now more willing to take risks. High literacy rates are another positive factor; 91 percent of Sri Lankan men and 81 percent of Sri Lankan women can read and write, and exposure to mass media has made farmers more receptive to new ideas and approaches. Another positive factor has been the USAID Mission's commitment to agribusiness development, and the autonomy and flexibility it has given to the managers of different projects. On the negative side, the Government's land tenure policy has impeded the growth of commercial farms. A 20-hectare ceiling on holdings dissuades many large and foreign landholders from investing in commercial farming. Potential investors in agribusiness have difficulty getting title to land, and getting an MASL annual permit involves a long process and an uncertain outcome. Many potential investors are also concerned that land policy may be reversed one day and become more restrictive.

Also, despite significant progress in recent years, Sri Lanka still lacks good roads, an adequate transportation system, and workable communication networks, including telephone and fax facilities. Post-harvest losses are high, especially from transporting agricultural produce. Research and extension for high-value crops

is weak and the country has only a limited ability to address the technical problems encountered in cultivation, transporting, and processing of these crops.

Bureaucratic delays and paternalism further impede progress. Sri Lanka's bureaucracy is more efficient and less corrupt than in many developing countries, but like bureaucracies everywhere, it resists change. Senior officials usually support agribusiness, but lower and mid-level officials still resist private investments in agriculture and agribusiness. The result is unnecessary delays in implementing the decisions made at higher levels. In the Mahaweli areas, because of recent settlement programs, restrictive government controls are especially evident.

Lessons Learned

1. It is more realistic to promote limited sourcing, technology transfer, and marketing arrangements between international firms and local entrepreneurs than to attract direct foreign investments by international firms.

An attempt was made to induce international firms to invest in the processing and marketing of Sri Lanka's nontraditional agricultural exports. These efforts failed partly because international firms are highly sensitive to a country's economic and political stability. More important, they usually prefer to grow high-value crops on large farms to ensure a steady supply and economies of scale. But foreign (corporate) ownership of large farms is not politically acceptable in Sri Lanka. Moreover, the country lacks the institutional and physical infrastructure international agribusiness firms need for farming, processing, and marketing. As a result, international firms did not invest in the agribusiness sector despite Sri Lanka's advantages: low wages, high literacy, proximity to rich and growing Asian markets, and greater proximity to Europe than East Asia enjoys.

2. Contract farming emerged as an effective way to link small farmers with agribusiness firms that process and export high-value agricultural exports. USAID programs should continue to explore such arrangements.

To the surprise of national planners and project designers, contract farming benefited both small farmers and agribusiness firms. Gherkins, the main nontraditional agricultural export crop, are produced mainly through contract farming. Contract farming assured small farmers of both essential inputs and a market and assured agribusiness firms of a steady supply of agricultural commodities at predetermined prices. Farmers get a fair price for their crops because of competition among agribusiness firms and because of MASL oversight of settlers' interests. And agribusiness firms find it more economical to purchase export crops from farmers than to grow their own. The farmers' high literacy rates, careful government monitoring, and the increasing involvement of farmer organizations and PVOs have helped safeguard farmers' interests.

3. Project designers should study the role microenterprises can

play in stimulating and expanding the agribusiness sector, particularly in underdeveloped regions.

In Sri Lanka, microenterprises involved in agricultural input supply, processing, and marketing have grown both in number and in size, generating more opportunities for work. These microenterprises, which cater mainly to domestic markets, could use program assistance especially credit, marketing advice, and management training. Microenterprises' role in promoting the agribusiness sector was not fully acknowledged in project papers, but with timely, focused program assistance, microenterprises could significantly contribute to value-added processing and could generate jobs.

4. The agribusiness program benefits small farmers and landless laborers. More important, it need not favor large landowners at the expense of small farmers, provided safeguards exist to protect small farmers' interests.

The agribusiness program increased the incomes of participating small farmers, and employment opportunities in rural areas have expanded, benefiting landless laborers. Moreover, the program has not accentuated differences in the size of landholdings. At first, political circles were concerned that, by cultivating high-value crops, a few successful farmers would informally acquire the land of less successful farmers transforming them into virtually landless workers. This didn't happen, partly because of the public and government commitment to equity, but mainly because contract farming enabled small farmers to grow high-value crops.

5. Program designers should consider how the growth of agribusiness will affect women, paying special attention to women's ownership of agribusiness enterprises.

The cultivation of high-value export crops, especially the gherkin, has had mixed effects on women. Although women's workload has increased, their incomes and standard of living, have improved. However, except for microenterprises, women-owned agribusinesses are practically nonexistent. Therefore, more attention to women's issues is necessary in agribusiness programs.

6. In economies where domestic markets for commercial crops or value-added processing are not developed, agribusiness programs should try to remove constraints on the domestic market to stimulate economic growth.

In Sri Lanka the agribusiness program has in its early stages focused largely on nontraditional agricultural export crops. Much of the technical assistance, training, and support has been geared to exploring export opportunities, attracting investments from large international firms, and strengthening the infrastructure for agricultural exports. The program paid too little attention to developing the domestic market, which could be much greater. The country imports large quantities of onions, peppers, and coriander, for example, which could be produced domestically with careful planning and targeted technical assistance. Minor improvements in

Mahaweli's transportation system could stimulate the cultivation of commercial crops and value-added processing for local and national markets.

7. Projects designed to introduce new crops, technologies, and marketing channels can be very costly. If adoption rates are low and benefits are small, the economic rate of return will be low. Economic rates of return were very low on both the MARD and MED projects. Crop diversification into high-yield crops has grown rapidly but is a very small share of total acreage. Additional farmer income from the new crops is also relatively low, owing in part to the high labor requirements of the new crops. While on- and off-farm employment has grown rapidly, not all of the new jobs can be attributed to the USAID projects, and income from those new jobs is relatively modest.

This Highlights summarizes the findings from the field evaluation of USAID's Agribusiness Program in Sri Lanka, conducted by Krishna Kumar and Joseph Lieberman of the Center for Development Information and Evaluation and Eugene Miller of Development Alternatives, Inc. The evaluation is part of a seven-country assessment of the USAID agribusiness program directed by Krishna Kumar. Documents can be ordered from the DISC, 1611 North Kent Street, Suite 200, Arlington, VA 22209-2111, telephone (703) 351-4006; fax (703) 351-4039.